

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act in general and furthers the objectives of Section 6(b)(5) in particular in that it is designed to prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transaction in securities, and, in general protect investors and the public interest.

(B) Self-Regulatory Organization's Statement on Burden on Competition

The Amex believes that the proposed rule change will not impose any burden on competition.

(C) Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments on the proposed rule change were neither solicited nor received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- (a) by order approve such proposed rule change, or
- (b) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street NW., Washington, DC 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in

the Commission's Public Reference Section, 450 Fifth Street NW., Washington, DC. Copies of such filing will also be available for inspection and copying at the principal office of the above-mentioned self-regulatory organization. All submissions should refer to File No. SR-Amex-95-43 and should be submitted by December 27, 1995.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority⁶
Margaret H. McFarland,
Deputy Secretary.

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[Release No. 34-36526; File No. SR-PSE-95-28]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Pacific Stock Exchange, Inc., Relating to Establishing a Hedge Exemption for Narrow-Based Index Options

November 29, 1995.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"), 15 U.S.C. 78s(b)(1), notice is hereby given that on November 1, 1995, the Pacific Stock Exchange, Inc., ("PSE" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II and III below, which Items have been prepared by the self-regulatory organization. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The PSE proposes to amend PSE Rule 7.6, "Position Limits for Index Options," to establish a hedge exemption from industry (narrow-based) index option position limits which would allow PSE members and member organizations, as well as public customers, to exceed the established position limits for narrow-based index options by three times the established position limit for such index options, provided that the position is "hedged" with shares of at least 75% of the number of stocks comprising the index.¹

⁶ 17 CFR 200.30-3(a)(12) (1994).

¹ Position limits impose a ceiling on the number of option contracts which an investor or group of investors acting in concert may hold or write in each class of options on the same side of the market (i.e., aggregating long calls and short puts or long

The text of the proposed rule change is available at the Office of the Secretary, PSE and at the Commission.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the self-regulatory organization included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The self-regulatory organization has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspect of such statements.

(A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

Purpose

The purpose of the proposed rule change is to establish a hedge exemption from the industry index option position limits established in PSE Rule 7.6(a).² Specifically, the PSE proposes to add Commentary .03 to PSE Rule 7.6, which will provide that industry index option positions may be exempt from established position limits for each contract "hedged" by an equivalent dollar amount of the underlying component securities or securities convertible into such components, provided that each option position to be exempted is hedged by a position in at least 75% of the number of component securities underlying the index, and that the underlying value of the option position does not exceed the value of the underlying portfolio. The value of the portfolio is: (a) the total market value of the net stock position,

puts and short calls). The PSE's proposal is identical to a proposal submitted by the Philadelphia Stock Exchange, Inc. ("PHLX"), See Securities Exchange Act Release No. 36380 (October 17, 1995), 60 FR 54403 (October 23, 1995) (File No. SR-PHLX-95-45).

² PSE Rule 7.6(a) provides the following position limits for industry index options: 5,500 contracts if, during the Exchange's semi-annual review, the Exchange determines that any single stock in the group accounted, on average, for 30% or more of the index value during the 30-day period immediately preceding the review; 7,500 contracts if the Exchange determines that any single stock in the group accounted, on average, for 20% or more of the index value for that any five stocks in the group together accounted, on average, for more than 50% of the index value, but that no single stock in the group accounted, on average, for 30% or more of the index value, during the 30-day period immediately preceding the review; or 10,500 contracts if the Exchange determines that the above conditions have not occurred.

less (b) the national value of (1) any offsetting calls and puts in the respective index option; and (2) any offsetting positions in related stock index futures.³ The values of any such index option position or related futures position are determined by aggregating the national value of each option contract comprising the position. Under the proposed exemption, position limits for any hedged industry index option may not exceed three times the limits established under PSE Rule 7.6(a).

Members, member organizations, and public customers seeking to use the proposed exemption must obtain prior Exchange approval. In addition, the exemption requires that both the option and stock positions be initiated and liquidated in an orderly manner. Specifically, a reduction of the option position must occur at or before the corresponding reduction in the stock portfolio position.

Under the proposal, exercise limits will continue to correspond to position limits, so that investors may exercise the number of contracts set forth as the position limit, as well as those contracts exempted by the proposal, during five consecutive business days.⁴

Currently, PSE Rule 7.6, Commentary .02, allows public customers to apply for position limit exemptions in broad-based index options that are hedged with exchange-approved qualified stock portfolios.⁵ Under the broad-based index option hedge exemption, a qualified portfolio is comprised of net long or short positions in common stocks or securities readily convertible into common stock in at least four industry groups and contains at least 20 stocks, none of which accounts for more than 15% of the value of the portfolio. To remain qualified, a portfolio must meet the standards at all time, notwithstanding the trading activity in the stocks or their equivalents.

Although the broad-based index option hedge exemption applies only to public customers, the Exchange believes it is appropriate to expand the availability of the proposed narrow-based index option position limit

exemption beyond public customers.⁶ The PSE believes that significant increases in the depth and liquidity of these index options could result from permitting firm and proprietary traders to be eligible for the exemption. According to the PSE, because customers rely, for the most part, on a limited number of proprietary traders to facilitate large-sized orders, not including such traders in the exemption effectively reduces the benefit of the exemption to customers. While large-sized positions in industry index options are most commonly initiated by institutional traders hedging stock portfolios on behalf of public customers, the PSE believes that proprietary traders should be afforded the same exemption so that they may fulfill their role as facilitators.

The Exchange believes that its proposed narrow-based index option hedge exemption should not increase the potential for disruption or manipulation in the markets for the stocks underlying each index. The PSE notes that the position limits for narrow-based index options, even tripled, are far less than the position limits for most broad-based index options. In addition, the proposal incorporates several surveillance safeguards, which the Exchange will employ to monitor the use of this exemption. Specifically, the Exchange will require that member firms and their customers who seek exemptions file a form with the PSE, in lieu of granting an automatic exemption similar to that for equity options. The PSE's Options Surveillance Department will monitor trading activity in PSE-traded index options and the stocks underlying those indexes to detect potential frontrunning and manipulation abuses, as well as review to ensure that the closing of positions subject to an exemption is conducted in a fair and orderly manner.

And lastly, the PSE notes that the provision itself contains several built-in safeguards. First, the hedge must consist of a position in at least 75% of the stocks underlying the index, so that the "basket" of stocks constituting the hedge will resemble the underlying index.⁷ Secondly, position limits may

not exceed three times the limit established under PSE Rule 7.6(a). This places a ceiling on the maximum size of the option position. Third, both the options and stock positions must be initiated and liquidated in an orderly manner, such that a reduction of the options position must occur at or before the corresponding reduction in the stock portfolio position. Lastly, the value of the industry index option position may not exceed the dollar value of the underlying portfolio. The purpose of this requirement is to ensure that stock transactions are not used to manipulate the market in a manner benefitting the option position. In addition, these safeguards prevent the increased positions from being used in a leveraged manner.

For the above reasons, the Exchange believes that the proposed narrow-based index option hedge exemption should increase the depth and liquidity of narrow-based index option markets and allow more effective hedging with underlying stock portfolios, without increasing the potential for market manipulation or disruption, consistent with the purposes of position limits. For the same reasons, the Exchange believes that exercise limits should correspond to the position limit exempted granted by this proposal.

Statutory Basis

The PSE believes that the proposal is consistent with Section 6(b) of the Act, in general, and with Section 6(b)(5), in particular, in that it is designed to remove impediments to and perfect the mechanism of a free and open market in a manner consistent with the protection of investors and the public interest.

(B) Self-Regulatory Organization's Statement on Burden on Competition

The PSE does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

(c) Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants or Others

Written comments on the proposed rule change were neither solicited nor received.

component. That amount divided by price = number of shares of component. Conversely, to determine how many options can be purchased based on a certain portfolio, divide the dollar amount of the basket by the index value \times the index multiplier.

³ National values are determined by adding the number of contracts and multiplying the total by the multiplier, expressing that number in dollar terms.

⁴ Exercise limits prohibit an investor or group of investors acting in concert from exercising more than a specified number of puts or calls in a particular class within five consecutive business days.

⁵ See Securities Exchange Act Release Nos. 32900 (September 14, 1993), 58 FR 181 (September 21, 1993) (order approving hedge exemption for broad-based index options on a pilot basis); 35738 (May 18, 1995), 60 FR 27573 (May 24, 1995) (order approving broad-based index option hedge exemption on a permanent basis).

⁶ The Exchange proposes to apply only the proposed narrow-based industry index option hedge exemption, and not the existing broad-based index option hedge exemption, to firms and proprietary traders as well as public customers. Telephone conversation between Michael Pierson, Senior Attorney, Market Regulation, PSE, and Yvonne Fraticelli, Attorney, Office of Market Supervision, Commission, on November 14, 1995.

⁷ To determine the share amount of each component required to hedge an index option position: index value \times index multiplier \times component's weighing = dollar amount of

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

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(a) By order approve such proposed rule change, or

(b) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying at the Commission's Public Reference Section, 450 Fifth Street, NW., Washington, DC. Copies of such filing will also be available for inspection any copying at the principal office of the above-mentioned self-regulatory organization. All submissions should refer to the file number in the caption above and should be submitted by December 27, 1995.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁸

Margaret H. McFarland,
Deputy Secretary.

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[Release No. 34-36532; File No. SR-NASD-95-58]

Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to the Date of Implementation of the NASD's Primary Market Maker Standards and the Duration of the Pilot Program for the NASD's Short Sale Rule

November 30, 1995.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ notice is hereby given that on November 27, 1995, the National Association of Securities Dealers, Inc. ("NASD" or "Association") filed with the Securities and Exchange Commission ("Commission" or "SEC") the proposed rule change as described in Items I and II below, which Items have been prepared by the NASD. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons. As discussed below, the Commission has also granted accelerated approval of the proposal.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

Pursuant to Section 19(b)(1) of the Act, the NASD is proposing to delay, from December 1, 1995 to February 1, 1996, the implementation date of the Primary Market Maker standards to be used to determine the eligibility of market makers for an exemption from the NASD's short-sale rule. The NASD also proposes to extend the termination date for the pilot period to August 3, 1996 instead of June 3, 1996. The text of the proposed rule change is as follows (additions are italicized; deletions are bracketed):

Article III, Section 1

* * * * *

Section 48

(1)(3) Until *February 1, 1996* [December 1, 1995], the term "qualified market maker" shall mean a registered Nasdaq market maker that has maintained, without interruption, quotations in the subject security for the preceding 20 business days.

* * * * *

Beginning *February 1, 1996* [December 1, 1995], the term "qualified market maker" shall mean a registered Nasdaq market maker that meets the criteria for a Primary Nasdaq Market Maker as set forth in Article III, Section 49 of the Rules of Fair Practice.

* * * * *

(m) This section shall be in effect until *August 3, 1996* [June 3, 1996].

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the NASD included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The NASD has prepared summaries, set forth in Sections A., B., and C. below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

On June 29, 1994, the SEC approved the NASD's short-sale rule applicable to short sales in Nasdaq National Market securities on an eighteen-month pilot basis through March 5, 1996.² The NASD's short-sale rule prohibits member firms from effecting short sales at or below the current inside bid as disseminated by the Nasdaq system whenever that bid is lower than the previous inside bid.³ The rule is in effect during normal domestic market hours (9:30 a.m. to 4:00 p.m., Eastern Time). As approved by the Commission, during the first year that the rule has been in effect (from September 6, 1994 to September 6, 1995), Nasdaq market makers who maintained a quotation in a particular Nasdaq National Market security for 20 consecutive business days without interruption are exempt from the rule for short sales in that security, provided that the short sales were made in connection with bona fide market making activity ("the 20-day" test). For the next six months of the 18-month pilot period (*i.e.*, September 6, 1995 through March 5, 1996), the "20-day" test for market maker exemptions from the rule was scheduled to be replaced with a four-part quantitative test known as the "Primary Market Maker (PMM) Standards."

Under the PMM Standards, to be eligible for an exemption from the short-sale rule, a market maker must satisfy at least two of the following four criteria: (1) The market maker must be at the best bid or best offer as shown on the Nasdaq

² See Securities Exchange Act Release No. 34277 (June 29, 1994), 59 FR 34885 (July 7, 1994).

³ A short sale is a sale of a security which the seller does not own or any sale which is consummated by the delivery of a security borrowed by, or for the account of, the seller.

⁸ 17 CFR 200.30-3(a)(12) (1994).

¹ 15 U.S.C. § 78s(b)(1) (1988).